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TAGS: ECON ETRD EINV EFIN EC
SUBJECT: ECUADOR ECONOMIC NEWS: CORREA ANNOUNCES NEW ECONOMIC MEASURES, CENTRAL BANK CUTS 2009 GDP GROWTH ESTIMATES, CAN RULES ON ECUADORAN SAFEGUARDS ON COLOMBIAN IMPORTS

REF: QUITO 566

¶1. (U) The following is a periodic economic update for Ecuador that reports notable developments that are not reported by individual cables. This document is sensitive but unclassified. It should not be disseminated outside of USG channels and should not be posted on the internet.

Highlights

-- President Correa Announces New Economic Measures

-- Central Bank cuts 2009 GDP growth estimate

-- GoE Fiscal Deficit in 2009

-- IMF allocation of SDRs to Ecuador to support GoE budget

-- Reorganization of Central Bank Board of Directors

-- CAN rules on GoE safeguards on Colombian imports

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President Correa Announces New Economic Measures

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¶2. (SBU) On August 26, President Correa announced that the GoE was submitting that same day a tax reform package to the National Assembly for its approval. He explained that these tax reforms were part of broader GoE measures to "face the international crisis," including reducing the current account deficit, using international reserves to fund domestic investment, promoting social justice, combating tax evasion, and boosting productive sector and internal demand. During his August 26 comments, Correa voiced his optimism about the economy, predicting GDP growth of 2% and annual inflation lower than 4%.

¶3. (SBU) Within the tax reform package, a handful of measures have received the most attention: 1) the increased tax on money remittances from 1% to 2%, aimed at stemming capital outflows, which totaled US$ 4.9 billion in 2008 and have already exceeded US$ 5 billion so far in 2009; 2) the planned repatriation of US$ 1.6 billion in international reserves to support domestic investments aimed at boosting economic activity; 3) the establishment of a minimum corporate income tax and a 10% tax on shareholder dividends of companies with high profit levels. (See septels for additional details on the tax reform plan and the GoE's plan to use international reserves to fund domestic investment.)

¶4. (SBU) Private analysts note that the overall goal of this tax reform package and the broader measures taken by the GoE are to generate revenues to cover the fiscal deficit, limit the current account deficit, and redistribute income. Many observers are critical of the August 26 announced measures, noting that increasing the tax on capital flows is unlikely to reduce outflows, which are high due to uncertainty about the economy and GoE policies. There is also concern that the GoE's decision to close positions in liquid short-term international assets and invest them in medium-term illiquid domestic assets will undermine financial stability and increase Ecuador's vulnerability to external shocks. Finally, many analysts disagree with Correa's optimistic growth estimates, with some expecting annual growth below even the Central Bank's 1% estimate.

Central Bank cuts 2009 GDP growth estimate

¶5. (U) On August 24, Karina Saenz, General Manager of Ecuador's Central Bank (BCE), revised downward the BCE's estimate for 2009 annual real economic growth to 1%, from its previous estimate of 3.5%. Although Saenz mentioned that "Ecuador has overcome the worst of the crisis" and would compare well this year against other countries in the region, the downward revision reflects the BCE's admission that the Ecuadoran economy has experienced a sharp downturn since late 2008, after posting 6.5% real growth in 2008.

¶6. (SBU) According to available Ecuadoran Central Bank data on quarterly GDP, the economy contracted 1.62% in the first quarter of 2009, compared to the fourth quarter of 2008. Many local private-sector economists argue that Ecuador's recession began in the fourth quarter of 2008, with GDP falling an estimated 0.25% (quarter-over-quarter). However, Central Bank President Carlos Vallejo has argued publicly that GDP at the end of the first quarter of this year registered real growth of 1.19% year-over-year (resulting from the statistical carryover of relatively strong growth during the second and third quarters of 2008), and he continues to predict positive real growth for full-year 2009 in the range of 2%.

¶7. (SBU) According to Central Bank estimates of economic activity, the country has experienced a sharp contraction in non-oil sectors of the economy, compared to previous years. The BCE estimates that during 2009 "construction and public works" will contract against 2008, from an annual increase of almost 14% to an estimated decline of 1%. Similarly, the growth rate of "government services" plummeted from almost 15% in 2008 to an estimated 2.5% in 2009. These reflect the GoE's inability to copy what it did in 2008 and drive economic growth through government expenditures. The BCE also expects limited growth but substantially lower than in 2008 in

private investment, financial services, and manufacturing. The BCE expects "oil and mining" to continue their recent trend of declining year/year at a rate of 4-5%.

GoE Fiscal Deficit in 2009

¶8. (SBU) According to Ecuador's Constitution, the GoE must submit the 2010 budget to the National Assembly within 90 days of President Correa's August 10 inauguration. The GoE is also obligated to provide the National Assembly with estimated fiscal program plans for 2011-2013. Finance Minister Viteri confirmed during a September 1 press conference that her Ministry is working on 2009 and 2010 budgets, with the goal of submitting both of them to the National Assembly in early November. Viteri commented that the 2009 budget, which was never approved by the legislature, is based on a US$ 35.5 per barrel price for Ecuadoran oil, whereas the average to date in 2009 is significantly higher at US$ 45/bbl. She noted that the 2010 budget will be based on a US$ 61/bbl oil price.

¶9. (SBU) There are varying estimates for the size of the GoE's fiscal deficit in 2009, a calculation complicated by the lack of the 2009 budget, the Finance Ministry's lengthy delay in publishing budget data, and the increase in recent months in the price of crude oil. The well-known local think tank "Fiscal Policy Observatory" estimates the fiscal deficit through July 2009 at US$ 420 million. However, this figure does not take into account GoE arrears to the social security agency (IESS) and delayed transfers to regional governments and to other public entities. The Fiscal Policy Observatory, which has a reputation for being pessimistic, estimates these arrears at about US$ 600 million, and estimates that the full-year 2009 fiscal deficit could be as high as US$ 2.5-3 billion.

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IMF allocation of SDR to Ecuador to support GoE budget

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¶10. (SBU) As with all other IMF members, on August 27-28 Ecuador received its share of the IMF's general allocation of US$ 250 billion in Special Drawing Rights (SDRs, or Derechos Especiales de Giro, DEGs, in Spanish). Ecuador's allocation totaled 224.1 million SDRs, or approximately US$ 350 million. Ecuador will reportedly receive a second allocation of SDRs in September, valued at close to US 50 million, stemming from the Fund's planned US$ 33 billion allocation of SDRs on September 9. The disbursement has generated some controversy in Ecuador, given President Correa's strong criticisms of the IMF, and there has been some debate over whether Ecuador would accept the disbursement. Central Bank Karina Saenz dismissed this controversy during a September 1 meeting with EconOffs. She stated that not only has Ecuador accepted the SDRs, the BCE has already requested IMF assistance with trading these SDRs to another member country for hard currency. Interestingly, Saenz noted that the resulting dollars will not be counted as international reserves on the BCE's balance sheet, as are Ecuador's existing stock of SDRs. Rather, the BCE will transfer the funds directly to the GoE Treasury accounts at the BCE.

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Reorganization of Central Bank Board of Directors

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¶11. (U) On July 30, 2009, the National Assembly approved a law that reorganizes the Board of Directors of the Central Bank of Ecuador (CBE). Ecuadorian President Correa's administration originally proposed the law, so it is assumed he will sign it and it will enter into effect by end-September. The new law replaces the current board of five officials nominated by the President and confirmed by the National Assembly, with a fixed slate that does not require National Assembly approval. The President will still name his representative as the BCE President, but other board members will be the Coordinating Minister for Production, Coordinating Minister for Economic Policy, the Minister of Finance, a representative of public financial entities, and the Secretary of National Planning. President Correa has not yet announced whether he will retain Carlos Vallejo, the current President of the CBE, as his representative on the Board.

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CAN rules on GoE safeguards on Colombian imports

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¶12. (SBU) In January 2009, the GoE imposed WTO Balance of Payments (BOP) safeguard provisions on certain imports, arguing they were necessary to confront Ecuador's developing BOP crisis. In July the GOE imposed further one-year emergency exchange safeguard measures, taking the form of additional tariffs ranging from 5% to 86% and targeting 1,346 Colombian products (Ref A). The GoE justified this action as a necessary response to the 18.5% depreciation of the Colombian peso, which the GoE attributed to Colombian Central Bank measures. The GoE argued that the weak Colombian peso undermined the competitiveness of Ecuador's dollarized economy, making Colombian exports to Ecuador cheaper.

¶13. (SBU) On August 7, the Andean Community's (CAN) General Secretary ruled that Ecuador must remove its exchange safeguards on the 1,346 Colombian products within 15 days. However, the CAN Secretariat appeared to take pains to avoid benefiting one country over the other, and also acknowledged that the Colombian currency devaluation between June 2008 and June 2009 had negatively affected Ecuadorian products' competitiveness. It, therefore, authorized Ecuador to apply corrective measures on 666 Colombian products, subject to several rather vague conditions. These conditions included the requirements that the corrective measures be transitory and applied only so long as the currency mismatch exists, and they cannot exceed the rate of devaluation in magnitude.

¶14. (SBU) The GOE has complied with the CAN ruling and has developed a new list of 666 safeguards on Colombian products. Coordinating Minister for Production, Nathaly Cely, who traveled to Lima in early August to negotiate the safeguards issue with the CAN Secretariat, has stated publicly on several occasions that Ecuador's safeguard measures accomplished their intended objectives of reducing Ecuador's trade deficit. According to Central Bank data, through June 2009, Ecuadoran imports are US$ 1.17 billion below their level during the equivalent period in 2008.
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